

Public Private Partnerships

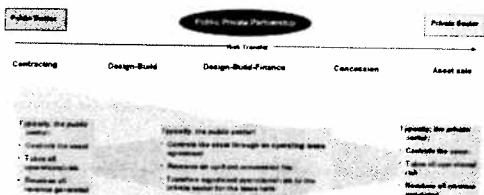


Definition of a PPP

- ▶ Contractual agreement between a public agency (federal, state or local) and a private sector entity structured to:
 - ▶ Optimize the skills and assets of each sector (public and private) in delivering a service or facility for the use of the general public
 - ▶ Allocate the risks in the delivery of the service and/or facility to the parties best able to manage them

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Key Aspects of PPPs



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Advantages of PPPs

- ▶ Improves cost effectiveness
- ▶ Reduces public capital investment
- ▶ Introduces private capital investment
- ▶ Reduces, shares, and allocates risk
- ▶ Improves efficiencies/earlier project delivery
- ▶ Maximizes use of each sector's strength
- ▶ Mutual rewards
- ▶ Shares resources
- ▶ Mobilizes excess or underutilized assets
- ▶ Better environmental compliance
- ▶ Promotes competition

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Keys to Successful PPPs

- ▶ Legislative and political environment
- ▶ Detailed business plan and strong project justification
- ▶ Guaranteed revenue stream
- ▶ Stakeholder support
- ▶ Pick your partner carefully
- ▶ Build on lessons learned - don't reinvent the wheel

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Michigan's Approach to PPPs

- ▶ Feasibility Study
 - ▶ A "scoping" project was undertaken to determine if suitable opportunities existed to justify and allow a more broad-based, detailed approach
- ▶ Strong policy statement
 - ▶ A state-wide office dedicated to public private partnerships (PPP Office) was established in the State Treasury Department
- ▶ Legislative support
 - ▶ FY2009 Budget
 - ▶ Enabling legislation

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Transportation Opportunities

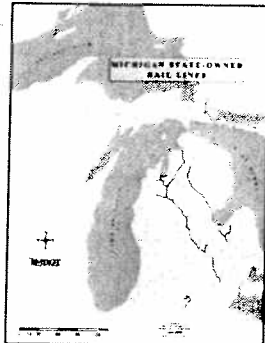
► Range of PPP delivery opportunities:

- Full concession
- Shadow tolling
- Availability based payment
- Design, build, operate, maintain
- Design, build, finance
- Design and build

PPP Success to date

State Owned Rail System

- PPP going back to the 70s
- Preservation of service
- State owns infrastructure
 - Major capital investments
- Private operator
 - Operates trains
 - Day to day maintenance
- Cost avoidance model




PPP Success to date

Meijer Carpool Parking

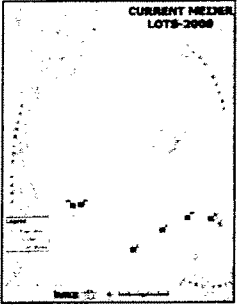
- Need additional carpool parking
- Pilot project to use designated spaces in Meijer parking lots
- 50 spaces in six lots:
 - Cascade, Lowell, Brighton, Jackson, Chesterfield Township, Auburn Hills
- Saving MDOT over \$1 million
- Proposed expansion to 66 lots; expected cost \$1 million with projected savings of \$15 million






PPP Success to date

Meijer – Pilot lots






PPP Success to date

Design Build Finance Pilot Projects

- ▶ **I-69 in Lapeer & St. Clair Counties**
 - ▶ Lapeer/St.Clair county line to Miller road
 - ▶ Highway reconstruction originally scheduled for 2012
 - ▶ Estimated cost of construction: \$44 million
- ▶ **M-21 over I-75 in Genesee County**
 - ▶ M-21 / I-75 interchange
 - ▶ Bridge replacement & building demolition originally scheduled for 2011
 - ▶ Estimated cost of construction: \$7 million
- ▶ Enabling legislation required to move to broader concession-type P3s in Michigan



Some Clarity on PPPs

The Concern:

- ▶ Will the quality of service decline under the Public Private Partnership method?

The Facts:

- ▶ Performance Based Contract – Public partner has more control over quality of services and Private partner takes significantly more risk
- ▶ The Private partner gets paid for the delivery of services – financial “penalties” if services don’t meet specified performance standards
- ▶ The Public partner can enforce provisions of the contract dealing with quality control through its contractual role as project monitor

▶ *Historically, Public Sector is often required to defer expenditures to avoid budget deficits or issue new debt. In contrast, a PPP provides a consistent and high standard of asset maintenance which must be priced and therefore budgeted from day one of the contract.*



Some Clarity on PPPs

The Concern:

- ▶ Will the Public Private Partnership method cost more than a traditional method (i.e. public entities can borrow money cheaper)?

The Facts:

- ▶ PPPs account for Whole Life Cost, reducing lifecycle costs
- ▶ Growing evidence demonstrates the total cost of PPPs is less than the total cost of traditional projects (on time and on budget)
- ▶ Private partner assumes the risk of cost overruns (during the construction and operating phase) – not the taxpayer
- ▶ The private sector can often leverage other revenue sources and development opportunities in maximizing the overall value of the project. Also, the private partner is often able to access similar sources of tax efficient financing available to the public sector.

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Some Clarity on PPPs

The Concern:

- ▶ Will the public partner lose control over services in a Public Private Partnership method?

The Facts:

- ▶ The Public partner chooses what services will be provided by the Private partner
- ▶ The Public partner has greater control over services and service levels through PPPs compared to the traditional approach
- ▶ Public authorities retain policy and legislative power to regulate the provision of services – requires change in approach: Compliance, Monitoring, Oversight
- ▶ PPP contracts enable the public sector to concentrate on its core services – Such as Education, allowing the private sector to efficiently deliver the non-core services such as building maintenance, cleaning services, and catering/food service.

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Some Clarity on PPPs

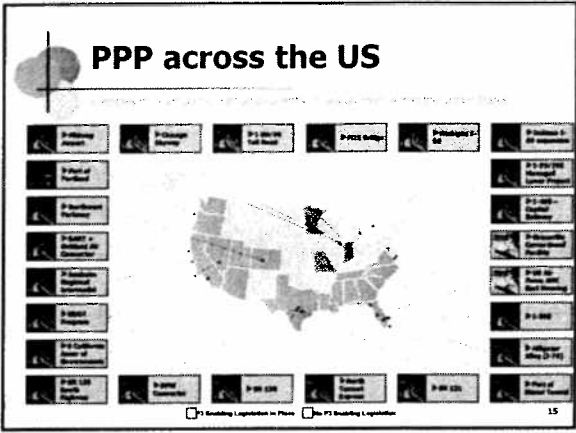
The Concern:

- ▶ Will the Public Private Partnership protect the value of public sector assets?

The Facts:

- ▶ Revenue sharing between the Public and Private sector partners based on gross revenue or maximum return to shareholders is commonly built into PPP agreements
- ▶ The PPP agreement often sets out agreement on sharing in any future refinancing gains realized by the private sector party
- ▶ Private sector can more efficiently manage many risks associated with the development of social infrastructure
- ▶ The PPP agreement can build in stringent conditions to ensure the asset is in mint condition at the end of the term when it is handed back to the Public Sector

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Testimony Regarding:
House Bill No. 4961, Providing for Public-Private Transportation Facilities
Testimony of Kara Rumsey, Advocate for the Public Interest Research Group in Michigan,
to the Michigan House Transportation Committee
June 18, 2009

Thank you, Honorable Chairwoman and Members of the Transportation Committee, for allowing me the opportunity to speak. My name is Kara Rumsey, and I testify on behalf of PIRGIM, the Public Interest Research Group in Michigan. PIRGIM is a statewide, citizen-based, non-profit, non-partisan public interest advocacy group that works to protect consumers and promote democracy.

I testify to express our concerns regarding House Bill 4961, which provides for public-private transportation facilities. Although we recognize that there is a role for both public and private entities in meeting Michigan's transportation needs, HB 4961 as currently written does not ensure that the public gets the value, efficiency, and safety it deserves from its transportation network. In order to ensure that public-private partnerships present a good deal for Michigan taxpayers, both now and in the long term, the law must include more explicit protections of the public interest.

Michiganders use our roads every day; we commute into Lansing or Detroit for work, or pile into the car and head Up North for a weekend of fishing or hunting. Our roads are a vital part of our daily lives, and any change in transportation policy must be carefully weighed to provide the highest possible quality of life for Michiganders.

Other states have undertaken public-private partnerships of their highways with mixed results. We at PIRGIM have looked at those agreements and their consequences, and based on that research, I have seven recommendations to ensure that roads continue to be operated in the best interest of the public and remain in public control under private-public partnership agreements.

PIRGIM would like to express particular concern regarding the following provisions of HB 4961:

1. Lack of criteria for protecting the public interest.

The bill states that the Department "may consider" a number of factors when evaluating bids, one of which is "benefits to the public." "Benefits to the public" cannot be an optional consideration, and this factor must be better defined. Here it would greatly improve the law to make clear:

a. That public control of transportation outcomes including traffic management shall be unimpeded.

Any driver knows how events that take place on one road affect other connecting and alternative routes. For instance, toll levels, maintenance and safety standards, and congestion on major highways have a substantial impact on the number of cars using alternative routes, including local roads and mass transit. Decisions about how to operate and manage these roadways have the effect of creating traffic policy for the state. Public control of key roads is necessary to ensure coherent statewide transportation planning and policy making.

Road privatization elsewhere shows that private operators' profit motive produces very different management decisions than government would. Two examples illustrate these potential dangers:

- **Non-Compete Clauses:** Some privatization contracts have explicitly limited states' ability to improve or expand nearby transportation facilities, which are viewed as "competing" roads from

the perspective of the private operator. For example, California, which used a private concession deal to create new toll lanes in the median of a state road, was subsequently forced to buy back the road because non-compete clauses prevented the state from improving the corridor, leading to high-profile litigation.

- Private Toll Decisions = Broad Private Control of Traffic Management: If the rules for increasing toll rates under Chicago's toll road deal had applied to New York's Holland Tunnel since its inception, that roadway could presently charge a one-way toll of more than \$180. As a practical matter, an operator would be unlikely to charge that price because drivers would instead take alternate routes. But this illustrates that the Chicago toll-increase schedule effectively allows the private operator to charge whatever maximizes its profits.

Transportation policy should be made according to what is best for the public, not determined by what best serves the financial interests of a private operator.

b. That the financial benefits to the state must exceed the value over time of what could have been obtained by collecting the same fees or tolls and obtaining any upfront funds through the public borrowing process.

While public-private partnerships can provide Michigan with badly needed upfront cash, that needs to be balanced against the revenue we could expect from those roads over time. In the case of toll roads, the experience has been that when the private mix of tolls and upfront cash is compared to what the public toll road authority could generate with the same toll increase schedule, it becomes clear that the private middle man is much more costly. Texas set a moratorium on these deals after finding out that they were losing over a billion dollars by going private. This makes sense because the private entity needs to pay shareholders a healthy profit, plus private entities borrow the upfront capital at a much higher rate. The public sector now complains about the high cost of borrowing money, but the gap between public and (higher) private rates has grown substantially since the financial downturn.

The public costs of evaluating, monitoring, and enforcing a potential private deal should also be considered in these calculations.

2. Lack of safeguards to ensure that adequate monitoring and enforcement capability is in place.

Any public-private partnership agreement needs to include provisions to ensure public safety and up-to-date maintenance, and the means to enforce those provisions. Private road contracts require ongoing vigilance. Private operators have a monetary incentive to underinvest if such underinvestment will not affect their bottom line. The federal GAO has determined that most states lack the army of expert lawyers and accountants that is necessary to ensure compliance with a contract on terms that protect the public.

3. Protection of the public interest is surrendered to the Department of Transportation.

Section 7B abdicates responsibility for protecting the public to the Department of Transportation. It makes sense for the executive branch to execute these protections, but the task of defining how to protect the public should be legislative, especially for major infrastructure deals that will last several decades. The proposed bill allows the deal to be defined in terms of what is necessary for economic viability, which explicitly puts the public's interest second to the private operators. Instead, the parameters for any potential deals should be defined in a way that puts the public's financial and other interests foremost. If private entities can't bid a good deal, then potential loss of those bids is not a problem.

4. Permitting unsolicited proposals.

By permitting unsolicited proposals, this law will result in private entities defining potential deals, rather than the Department of Transportation determining public needs and then seeking bidders. When private entities are allowed to drive the planning process and timelines rather than a transparent public process, the public interest can too easily become secondary to maximizing profits through higher tolls and more traffic.

5. Lack of time limit to contract terms.

No deal should last longer than 30 years because of uncertainty over future conditions and because the risks of a bad deal grow exponentially over time.

Consider the examples of Chicago and Indiana, which have lease deals that will stretch for multiple generations: 99 years and 75 years respectively. To appreciate how profound future changes will be over these time frames, they must be put in perspective. Consider these transportation-related milestones: Henry Ford introduced the Model T in 1908, 101 years ago; the George Washington Bridge opened in 1931, 78 years ago; and Congress created the interstate highway system in 1956, 53 years ago. From these markers, it's clear that massive, unforeseeable changes will likely take place for transportation technology, networks, demographics, and the distribution of population over time frames like those in Chicago and Indiana. In the face of such uncertainties, Michigan cannot predict its transportation needs, nor the revenue potential of toll roads, well enough to negotiate a deal that fairly allocates risks, dictates policy, or sets a fair price.

6. Exemption from transparency and disclosure laws.

The bill allows the private entities to define which information they want to keep secret from the public and shields it from the Freedom of Information Act. This is not the way to protect the public. Ideally, all documents and communications should be completely open. Failing that, private entities should be required to demonstrate that keeping such information secret is vital to their proprietary interests; the secrecy should be time-limited; and the claimed needs for secrecy should be balanced against the public need for open government.

7. No retention of legislative authority to approve or reject a deal.

The proposed bill relinquishes the legislature's responsibility for approving public-private partnerships, even in the case of a large dollar value deal. Given the profound implications of these deals for the state's economy and transportation policy, legislators should take responsibility for final approval.

Conclusion

While public-private partnerships may seem like free money, it is clear that these partnerships hold hidden costs. In designing the parameters for public-private partnerships, we hope the legislature will balance the current needs of Michigan against the importance of maintaining public control and the public benefit of our roads in the near and long term.

Thank you for allowing me today to share the views of the Public Interest Research Group in Michigan. I hope that you will take these concerns seriously; the effect of irresponsible deals would be suffered for generations. I look forward to answering any questions that you might have.